Supreme Court, U.S.
FILED

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No. _____

In The

Supreme Court of the United States

SURETY INVESTMENT RECOVERY SERVICES, INC.,

Petitioner,

v.

AMERICAN INSURANCE COMPANY, SEABURY & SMITH, INC., AND NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA.,

Respondents.

On Petition For Writ Of Certiorari To The Supreme Court Of Washington

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

- Does the refusal of the Washington Supreme Court to permit petitioner's appeal in accordance with the opinion of the Washington Court of Appeals that a principal cannot sue its surety, American Insurance Company, on surety bonds it issued for its principal, deny petitioner due process and equal protection of the laws under the Fourteenth Amendment?

- Whether the Washington Supreme Court, in dismissing the appeal in accordance with the refusal of the Court of Appeals to review alleged errors on meritorious discovery and summary judgment issues that concern Seabury & Smith, Inc., and National Union Fire Insurance Company, subsequent to dismissals effected by plaintiffs during the appeal because of judgments against them, deprived petitioner of the due process of law guaranteed by the Fourteenth Amendment?

PARTIES TO PROCEEDINGS

The following list identifies all parties to the proceedings in the Washington Supreme Court:

Surety Investment Recovery Services, Inc.

American Insurance Company

Seabury & Smith, Inc.

National Union Fire Insurance Company of Pittsburgh, PA

Kochcapital, Inc.

Thomas Cacciola & Marlene Cacciola

Peter Vetrano & Lena Vetrano

Wallace Rudolph & Janet Rudolph

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Supreme Court Rules, petitioner states the following: Surety Investment Recovery Services, Inc., is a Delaware corporation, and has no parent, subsidiary or publicly held corporations or companies owning 10% or more of the corporation's stock.

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PETITION FOR WRIT OF CERTIORARI

The petitioner hereby respectfully petitions for a writ of certiorari to review the judgment of the Supreme Court of Washington which refused to permit its appeal in accordance with the opinion of the Washington Court of Appeals that a principal cannot sue its surety, American Insurance Company, on surety bonds it issued for its principal, and which arbitrarily dismissed its appeal and cause of action against Seabury & Smith, Inc., and National Union Fire Insurance Company subsequent to dismissals effected by plaintiffs during the appeal because of judgments against them on meritorious discovery and summary judgment issues in contravention of *Purchase v. Meyer*, 108 Wn.2d 220, 737 P.2d 661 (1987) (*en banc*), and established precedent.

OPINIONS BELOW

The September 5, 2000, order of the Supreme Court of Washington dismissing the petitioner's appeal is unreported and is reproduced in the appendix to this petition. (Petitioner's Appendix A, pg. 1). The related February 25, 1999, decision of the Court of Appeals, Division II, State of Washington, is unreported and is reproduced in Pet. App. B, 1-9. The orders of the Pierce County Superior Court are reproduced at Pet. App. C, 1-17.

JURISDICTION

The judgment of the Supreme Court of Washington dismissing the petitioner's appeal was issued on September 5, 2000. This Court's jurisdiction in this case is invoked pursuant to 28 U.S.C. Section 1257(a).

STATUTES AND CONSTITUTIONAL PROVISIONS INVOLVED

This case involves the Fourteenth Amendment to the United States Constitution, which reads in relevant part as follows:

> Amendment XIV:
>
> . . . . No state shall . . . deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

STATEMENT OF THE CASE

Introduction. This is a civil action involving the American Insurance Company, Seabury & Smith, Inc., and the National Union Fire Insurance Company of Pittsburgh, PA. The plaintiffs (Thomas and Marlene Cacciola, Peter and Lena Vetrano, and Wallace and Janet Rudolph) are former customers of Kochcapital, Inc. ("KI"), a stock brokerage firm which was expelled from NASD membership in SEA-535 on September 28, 1990, and fined $244,000 for violations of SEC Rule 15c2-6, 17 C.F.R. § 240.15c2-6 (1990), the "cold call" rule. There were also rescission orders of $232,000 in these proceedings. Pet. App. A, 14.

On January 28, 1991, the decision in SEA-535 was affirmed by the NASD Board of Governors. On December 23, 1992, the SEC sustained the appeal of the NASD's decision in SEA-535. Pet. App. A, 14.

KI has also been the subject of federal court proceedings brought by the SEC for effecting customer transactions in designated securities ("penny stocks") in violation of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(c)(2), and Rule 15c2-6 thereunder. On May 12, 1992, a permanent injunction was entered against KI. The securities at issue which were also purchased from KI by

plaintiffs were Genesis Capital, Inc., International Environmental Group, Inc., Unifirst Corp., and other designated securities. In these securities, there were more than 800 customer transactions involving more than $4 million. The injunction issued in federal court was effective nationally. Pet. App. A, 14.

The claims against American, Seabury & Smith and National Union arise from plaintiffs' losses of approximately $200,000 in these securities, and are based on assignments from KI of its fidelity bond and surety bonds in August 1994 and October 1995. Pet. App. A, 14-15. The bonds assigned by KI to plaintiffs were issued by American and National Union through Seabury & Smith and the NASD fidelity bond and surety bond programs. Pet. App. A, 15. In December 1999 and April 2000, plaintiffs effected an assignment of their rights in the fidelity and surety bonds to petitioner, a corporation formed to administer recovery on the rescission orders in SEA-535, and on behalf of KI accounts in states where bonds were in place. Pet. App. A, 5-6.

Surety Bonds. The 2nd amended complaint, which included American as a party, was filed on January 5, 1996, and alleges that KI maintained surety bonds in the states of Oregon ($10,000), Idaho ($25,000), and Arizona ($25,000). Discovery established that KI also had surety bonds in the following states:

STATE	AMOUNT	ISSUED	CAN-CELLED	ENTITY CAN-CEL'G
Alaska	$ 5,000	1988	Unknown	Seabury & Smith
Arizona	$25,000	1988	1991	" " "
Hawaii	$ 5,000	1988	1991	" " "
Idaho	$25,000	1988	1991	" " "
Iowa	$15,000	1989	1992	" " "
N.Dakota	$25,000	1990	1991	" " "

Oregon	$10,000	1988	1991	" " " "
S.Carolina	$10,000	1989	Unknown	" " " "

Pet. App. D, 1-11. The surety bonds provided by American to KI all essentially provide that they are for the use and benefit of any person(s) having a cause of action under the laws of the states where bonds were issued, and that such person(s) may initiate suit in any court of competent jurisdiction against the principal and/or the surety on the bonds. Pet. App. D, 7, 9-10.

In October 1996, American filed a motion for summary judgment. Its motion was granted on January 31, 1997, and a motion to amend the 2nd amended complaint to assert claims on KI's surety bonds in these additional states was denied on the same date. A motion for reconsideration of these orders was denied on February 28, 1997. Pet. App. C, 1-6. The basis of the dismissal is not apparent from the record.

Fidelity Bonds. The NASD Rules of Fair Practice, Art. III § 32 (1990), require fidelity coverage of not less than 120% of a member's required net capital under Rule 15c3-1. Pursuant to SEC Rule 15c3-1(a), 17 C.F.R. § 240.15c3-1(a) (1990), a securities dealer shall at all times have net capital of not less than $25,000 or $25,000 plus the sum of each subsidiary's minimum net capital requirement which is consolidated under Rule 15c3-1(c), 17 C.F.R. § 240.15c3-1(c) (1990)[1]. Also, Rule 15c3-1a(4)

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[1] The rule provides that every broker or dealer in computing its net capital shall consolidate in a single computation assets and liabilities of any subsidiary or affiliate for which it guarantees, endorses or assumes directly or indirectly the obligations or liabilities. The assets and liabilities of subsidiaries or affiliates whose liabilities and obligations have not been assumed directly or indirectly by the broker or

(1990) (capital requirements for market makers) must be complied with.

The 2nd amended complaint (1/5/96) alleges that KI was a member of the NASD from October 1987 thru February 1991 and that it was insured under a blanket fidelity bond purchased through the NASD fidelity bond program from Seabury & Smith and National Union, that KI was subject to SEC Rule 15c3-1, and that its net capital levels exceeded $100,000 pursuant to audited financial statements prepared by its accountants. It is undisputed that KI had approximately eleven (11) branch offices throughout the country as of September 1990.

With respect to Seabury & Smith and National Union, the 2nd amended complaint primarily alleges negligence and contract claims in failing to provide adequate fidelity bonding for KI in 1989, 1990 and 1991, in failing to provide KI with an increase in its bonding, even though it requested increased coverage in the last quarter of 1990, and in jointly terminating its bond coverage in November 1990 when they knew or should have known that the firm was operating without a bond and effecting securities and cash transactions for public customers in violation of NASD rules.

On December 18, 1995, a few weeks before the 2nd amended complaint was filed, plaintiffs agreed with Seabury & Smith to an order of dismissal of Claim 4 of the 1st amended complaint. Claim 4 alleges that American and Seabury & Smith are liable on the surety bonds. The dismissal was based on a Seabury & Smith declaration that it is not an underwriter of surety bonds[2]. In January

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dealer may also be consolidated if an opinion of counsel is obtained under the rule.

[2] Claim 4 of the 2nd amended complaint deletes Seabury & Smith as a party allegedly liable on the surety bonds.

1996, a Seabury & Smith declaration similarly stated that it does not underwrite fidelity bonds, and has never been an underwriter of fidelity bonds. The declaration echoed its status as not underwriting surety bonds. Pet. App. E, 6, 9.

In March 1996, Seabury & Smith filed a motion for summary judgment in essence arguing that it is the administrator of the NASD fidelity bond and surety bond programs underwritten by National Union and American. Seabury & Smith argued that the threshold determination is whether a duty of care is owed by the defendant to the plaintiff, *Taylor v. Stevens County*, 111 Wn.2d 159, 163, 759 P.2d 447 (1988), and moreover, while the NASD bonding rule and net capital rule may require a member broker-dealer to be bonded to a certain amount, the obligation to purchase and maintain proper bond coverage rests with the NASD member pursuant to self-rating applications, and that even if KI was not adequately bonded, it had no obligation to verify, audit or enforce KI's compliance with these rules. Pet. App. E, 1-2, 6, 9. In these proceedings, facts surfaced showing that Seabury & Smith underwrites securities dealer blanket bonds for NASD members. Pet. App. E, 13.

On April 12, 1996, Seabury & Smith's motion for summary judgment was continued by the trial court. The court stated that it was unclear about the working relationship between Seabury & Smith and the NASD, available bonding alternatives, and the amount of the bond required in this case, and that it could not determine if there is a duty and to what extent the duty is. Pet. App. F, 1-7.

In August 1997, Seabury & Smith and National Union re-filed their motions for summary judgment. The motions relied heavily on the Declaration of James Dawson of the NASD's Seattle offices. Mr. Dawson describes

KI as subject to SEC Rule 15c3-1(a)(1), that the firm was required to have minimum net capital of $25,000, and that under Art. III § 32, its required fidelity coverage was $30,000. His declaration also states that the NASD has not delegated its regulatory functions with the fidelity bond rule to any outside entity, and that it did not expect nor would it allow Seabury & Smith and National Union to regulate or enforce NASD members' compliance with the fidelity bond rule or net capital requirements[3]. Pet. App. A, 17.

From their declarations, the insurers argued that neither was responsible for administering or enforcing SEC and NASD rules, and that the NASD did not intend for them to have a responsibility for determining or verifying net capital and fidelity bond coverage for NASD members in the fidelity bond program.

The CR 30(b)(6) deposition of the NASD was taken in October 1997. The deposition established that Mr. Dawson was not familiar with Seabury & Smith, that he had no knowledge about other providers of fidelity bonds in the securities industry, and that he did not know whether companies that provide these bonds require audited financial statements as part of the application process. Mr. Dawson testified that he was not familiar with the procedures in which fidelity bonds are issued in terms of

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[3] John Taylor, a retired NASD officer who oversaw the fidelity bond program in 1982, submitted a declaration for Seabury & Smith with similar statements. In August 1997, plaintiffs sought to compel Mr. Taylor's deposition, and the depositions of Victor Romanov and Andrew Forstenzer of Seabury & Smith and Steve Dickson and Jon Webber of National Union. They respectively are corporate counsel for the insurers, and provided or assisted in providing answers to discovery requests. Pet. App. A, 17-19. The motions were denied. Pet. App. C, 7.

the amount of the bond and underwriting risks. He also testified that he did not know how companies that issue fidelity bonds calculate what the amount of a bond should be, and that he didn't know how they view broker-dealer Focus Reports in issuing fidelity bonds. Pet. App. G, 6-7, 10-17.

CR 30(b)(6) depositions of Seabury & Smith and National Union were also taken in this period. Through the depositions, facts surfaced showing that there is a captive entity in the fidelity bond program, the Security Dealers Insurance Company ("SDIC"), a corporation apparently created and capitalized by the NASD, and that there are reinsurance agreements and treaties involving SDIC through which the NASD, Seabury & Smith and National Union may share in the proceeds of the bond program.

Seabury & Smith and National Union take the position that the captive entity did not come into existence until 1993. The concept of a captive in the NASD fidelity bond program goes back to 1980, Pet. App. G, 18-20, and National Union's designate testified that contracts involving SDIC change on a yearly basis. He also testified that he did not know when the captive was formed or if a captive existed prior to 1993, and he testified that there are in fact contracts between SDIC and National Union. He as well stated that he wasn't sure if Seabury & Smith is a party to contracts and reinsurance treaties with SDIC. Pet. App. A, 19-20.

Motions to compel production of documents on contracts and business agreements between Seabury and Smith, National Union, and the NASD, including SDIC, records of corporate meetings and minutes of meetings for SDIC, and reinsurance agreements involving SDIC, Seabury & Smith, National Union and the NASD were filed by plaintiffs. Seabury & Smith responded that there

are no written contracts between itself and the NASD relating to the fidelity bond program, and refused to respond to document requests involving SDIC because they are not "reasonably calculated to lead to the discovery of admissible evidence." Documentation in support of the motion included a Seabury & Smith internal message requesting its contracts with AIG and the NASD. Pet. App. H, 1. National Union also refused to produce these documents[4].

The motions to compel were denied. Pet. App. C, 8. A motion for reconsideration included financial statements and FOCUS reports for KI (6/89-1/91), documents from Seabury & Smith and National Union competitors (CNA, ITT Hartford & Travelers Property Casualty), and Declarations from Don W. Jones. Pet. App. A, 20.

In his declaration, Don Jones stated that he was employed by KI at its main offices in Washington, and that he was the head compliance officer for the main office and KI's branch offices. He stated that he had seen the KI's EOM Trading Reports, and that KI made a market in about 75% of the securities in these reports. He also stated that he had seen KI's financial statements for 1988, 1989, and 1990, and that KI's trading revenues in 1989 and 1990 were based on gross trading revenues for its main office and its branch offices. His declaration states that the main office retained ultimate responsibility for the actions of KI's brokers at its branch offices, that branch managers had responsibility for approving securities transactions, but he was responsible for approving transactions when they were relayed to the main office. Pet. App. A, 20-21.

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[4] American International Group is abbreviated "AIG." National Union is an AIG company. American is or may also be an AIG company.

The fidelity bond applications for CNA, ITT Hartford and Travelers are the same, "Application for a Financial Institution Bond, Standard Form No. 14 for Broker/Dealers." Information on business operations includes the number of salaried officers and employees, the number of NASD registered representatives, the number of locations in the U.S., and a statement of total assets and losses during the past three years. Seabury & Smith and National Union also use the Standard Form No. 14 for Broker/Dealers, and Seabury & Smith's designate testified that SEC Rule 15c3-1 is incorporated as part of the Form 14 standard bond form. Pet. App. A, 21.

The motions for summary judgment of Seabury & Smith and National Union were granted on December 5, 1997. Pet. App. C, 9-12. The motion for reconsideration filed by plaintiffs of the denial of the motions to compel was denied on January 16, 1998. Motions for judgments against plaintiffs pursuant to Civil Rule 11 and RCW 4.84.185 were filed by Seabury & Smith and National Union, and granted by the trial court on January 27, 1998, and February 17, 1998. Pet. App. C, 13-16. Judgments for approximately $5,700 were entered against plaintiffs at this time.

Timely notices of appeal of the trial court's orders were filed by plaintiffs on January 5, 1998, and March 18, 1998. In August and November 1998, during the pendency of the appeal, motions for dismissal of the appeal effected by Seabury & Smith, National Union and plaintiffs were filed with the Court of Appeals. The judgments held by the insurers against plaintiffs were released, and on August 31, 1998, and December 11, 1998, orders of dismissal were filed and entered by the Court of Appeals.

Decisions on Appeal. On February 25, 2000, the Washington Court of Appeals affirmed the judgments of the trial court in favor of American, Seabury & Smith and

National Union. With respect to American, the Court of Appeals states the question whether a principal on a surety bond may also be an obligee such that it may sue the surety to recover the amount of the bond(s). It held that the general rules of suretyship law do not allow a principal to sue a surety under the terms of the bonds issued by American. The appeal of discovery and summary judgment issues with respect to Seabury & Smith and National Union was continued pursuant to Washington law and the principles in *Purchase v. Meyer*, 108 Wn.2d 220, 229-30, 737 P.2d 661 (1987) (*en banc*). Again, however, the Court of Appeals refused to review alleged errors in the summary judgment proceedings and in denying motions to compel production of documents on the ground that the appeal with these parties was dismissed with prejudice. Pet. App. B, 5-7.

Before the Washington Supreme Court, petitioner argued that the decision of the Court of Appeals as it concerns American cannot be reconciled with the many cases and authorities that support and are clearly permissive of principal rights to maintain suit against the surety on a surety bond[5], that there are no precedents or principals of law or provisions in the bonds that prevent this[6], and that the decision implicates equal protection principles in the application of the law to this case. See, *e.g.*, *Lindsey v. Normet*, 405 U.S. 56, 77 (1972). Petitioner also argued that there were important discovery and summary judgment issues with Seabury & Smith and

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[5] See Restatement (Third) of Suretyship and Guaranty § 22 (1995); 72 C.J.S. Principal and Surety § 226 (1987) (citations omitted); Udelman, *Surety Contractors: Are Sureties Becoming General Liability Insurers*, 22 Ariz. St. L. J. 469, 471-485 (1990).

[6] See *supra*, at 4. The surety bonds issued by American are expansive in their coverage, (*e.g.*, " . . . for the use and benefit of any interested person."). Pet. App. D, 7.

National Union that should be decided in accordance with *Purchase v. Meyer*, 108 Wn.2d 220, 737 P.2d 661 (1987), and that the decision conflicts with, and by implication contravenes, the decisions in *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 351 (1977), and *Hickman v. Taylor*, 329 U.S. 495, 501 (1947). The federal issues accordingly were properly raised in the Washington courts. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 159 n. 5 (1980).

REASONS FOR GRANTING THE PETITION

Section I of this petition discusses the importance of the federal question at issue in the action with the American Insurance Company, as well as the conflict between the decision of the Supreme Court of Washington, and the reasoning of a number of this Court's prior decisions. Section II discusses the conflict between, on the one hand, the decision of the Washington Supreme Court in the action with the insurers and, on the other, some of these same cases and two other decisions of this Court, but in a slightly different setting. Before turning to these cases, it should be noted that this case involves private parties, and that the decisions of the Court of Appeals refusing to recognize meritorious causes of action protected by the Fourteenth Amendment, and of the Washington Supreme Court dismissing the appeal involves state action and are reviewable under the Fourteenth Amendment. This has traditionally been clear from the cases in which this Court has reviewed state appellate procedures under the Fourteenth Amendment and the federal constitution in cases between private parties. See, *e.g.*, *Honda Motor Co. v. Oberg*, 512 U.S. 415, 427-35 (1994); *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 311-13 (1950); *Martin v. Hunter's Lessee*, 14 U.S. (1 Wheat.) 304, 340-44 (1816).

I.

THE DECISION OF THE SUPREME COURT OF WASHINGTON RAISES IMPORTANT QUESTIONS OF FEDERAL CONSTITUTIONAL LAW, AND CONFLICTS WITH THIS COURT'S DECISIONS IN *LOGAN v. ZIMMERMAN BRUSH CO.*, 455 U.S. 422 (1981), *LINDSEY v. NORMET*, 405 U.S. 62 (1971), *AND BODDIE v. CONNECTICUT*, 401 U.S. 371 (1971)

A. DUE PROCESS

In a number of cases that have been decided by this Court over the years, it has consistently been held that a cause of action is a form of property protected by the Due Process Clause of the Fourteenth Amendment. *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 428 (1982); *Brinkerhoff-Faris Co. v. Hill*, 281 U.S. 673, 678-79 (1930). In these cases, the Court was in essence presented with state court deprivations of property through dismissals of cases in civil actions without a remedy.

In *Logan*, an employee of the Zimmerman Brush Co. was discharged purportedly because his short left leg made it impossible for him to do his duties as a shipping clerk. The appellant timely filed a claim under the Illinois Fair Employment Practices Act with the Illinois Fair Employment Practices Commission for unlawful termination of employment, but through inadvertence, the Commission scheduled a statutorily required fact-finding conference to obtain evidence, ascertain the parties' positions, and explore settlement, for a date 5 days after expiration of the 120-day statutory period for convening the conference. The Commission denied a motion by the company to dismiss the claim for failure to hold a timely conference. On an appeal, the Illinois Supreme Court held that the failure to comply with the 120-day conference requirement deprived the Commission of jurisdiction to consider appellant's claim, and also rejected appellant's

federal constitutional arguments that terminating his claim because of the Commission's failure to hold a timely conference would violate appellant's rights to due process and equal protection of the laws.

The case was appealed to this Court, and in an opinion by Justice Blackmun, the Court reversed, holding that the appellant was deprived of a protected property interest in violation of the Due Process Clause of the Fourteenth Amendment. *Logan*, 455 U.S., at 422. The Court wrote that the appellant's right to use state law adjudicatory procedures is a species of property protected by the Due Process Clause, and that this right is an entitlement under state law that cannot be removed except for cause. *Id.*, at 429-33. That is, the right to redress is guaranteed by the State, with the adequacy of a claim assessed under what is a "for cause" standard based upon the substance of the evidence. *Id.*, at 431. Justice Blackmun reasoned that unlike *Martinez v. California*, 444 U.S. 277 (1980), where a substantive immunity defense was found to be an arguable aspect of the State's definition of the property interest, the 120-day limitation for holding a conference in the Act does not affect the outcome of a claim, and is functionally equivalent to a procedural limitation on a claimant's ability to assert his rights. It is not a substantive element of a claim under the Act. 455 U.S., at 433. The Court concluded that under *Boddie v. Connecticut*, 401 U.S. 371 (1971), the Fourteenth Amendment requires " 'an opportunity . . . grant at a meaningful time and in a meaningful manner' . . . 'for [a] hearing appropriate to the nature of the case,' " and it was this opportunity that the appellant was denied. 455 U.S., at 437.

In *Brinkerhoff-Faris*, this Court earlier held that the Due Process Clause of the Fourteenth Amendment was violated in a civil case where the Missouri Supreme Court affirmed a state court's dismissal of an action brought by

the Brinkerhoff-Faris Trust & Savings Company, acting as trustee for its shareholders, to enjoin the collection of a state tax which allegedly discriminated against the bank's shareholders by assessing bank stock at full value, while omitting to assess certain classes of property and assessing all other classes of property at 75% or less of their value. The Missouri Supreme Court affirmed the dismissal on the ground that the bank had an adequate remedy before the state tax commission and had not pursued its administrative remedies, when prior to its holding in the present case, had held that the tax commission lacked precisely the power under the statute at issue to hold a hearing on a taxpayer's precollection action for relief from an allegedly discriminatory state tax assessment. It also held that because the plaintiff had this remedy, it was not entitled to equitable relief, and because plaintiff had not complained to the tax commission, "it was clearly guilty of laches in not so doing." 281 U.S., at 675-76. At this point, however, it was too late for the bank to avail itself of the new remedy, and moreover, the tax commission could not grant it relief because, under the state court's decision, it was guilty of laches and the time in which the commission could act had expired. *Id.*, at 677 and 679.

This Court's opinion, authored by Justice Brandeis, noted that the state court refused to hear the complaint and denied all relief because the bank did not first seek an administrative remedy before the tax commission, when in fact none was available, "and which is not now open to it," and by denying to it the only remedy available for the enforcement of its right, the decision deprives the plaintiff of its property. He wrote that, "The federal guarantee of due process extends to state action through its judicial as well as through its legislative, executive or administrative branch of government." 281 U.S., at

679-80. The concern, said Justice Brandeis, is with the question whether the plaintiff has been accorded due process in the primary sense, whether it has had an opportunity to present its case and be heard in its support. *Id.*, at 681.

The Court concluded that the state court has the power to construe the statute dealing with the tax commission, and to reexamine and overrule its earlier holding abrogating the power of the tax commission to accord relief in cases like this, "but, while it is for the state courts to determine the adjective as well as the substantive law of the State, they must, in so doing, accord the parties due process of law. *Whether acting through its judiciary or through its legislature, a State may not deprive a person of all existing remedies for the enforcement of a right, which the State has no power to destroy, unless there is, or was, afforded to him some real opportunity to protect it." Id.*, at 681-82. (emphasis added).

In a more recent case from the Alabama Supreme Court, the property interest principles in *Logan* and *Brinkerhoff* have been applied by this Court in a summary judgment setting to the application of state law res judicata principles as violative of the Due Process Clause of the Fourteenth Amendment. In *Richards v. Jefferson County*, 517 U.S. 793 (1996), petitioners filed a state court class action challenging a local occupation tax as violating the state and federal constitutions. The county moved for summary judgment arguing that the claims were barred by a prior adjudication of the tax in an action by the City of Birmingham, which was consolidated for trial with a suit by other taxpayers. In the prior action, the Alabama Supreme Court upheld the tax in *Bedingfield v. Jefferson County*, 527 So.2d 1270 (1988). The county's motion was granted on the state constitutional claims, but not on the federal claims because they were not decided

in *Bedingfield*. The Alabama Supreme Court held that the federal and state claims were barred by this prior action. It stated that the complaints and the briefs in *Bedingfield* had alleged and argued federal equal protection issues, that the taxpayers there adequately represented petitioners because their interests were essentially identical, and because the prior judgment was res judicata on all matters litigated and decided by it, and on all relevant issues which could have been but were not raised and litigated in the suit.

This Court, in an opinion by Justice Stevens, reversed and held that under *Hansberry v. Lee*, 311 U.S. 32 (1940), it violates the Due Process Clause of the Fourteenth Amendment to bind litigants to a judgment rendered in an earlier adjudication to which they were not parties and in which they were not adequately represented. *Richards v. Jefferson County*, 517 U.S., at 794. Speaking for a unanimous Court, Justice Stevens wrote:

> To conclude that the suit may nevertheless be barred by the prior action in *Bedingfield* would thus be to deprive petitioners of their "chose in action," which the Court has held to be a protected property interest in its own right. *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 429-30 (1982); *Philips Petroleum Co. v. Shutts*, 472 U.S., at 812 (relying on *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950)); *Hansberry v. Lee*, 311 U.S., at 37.

Richards v. Jefferson County, 517 U.S., at 804.

The Due Process Clauses of the Fifth and Fourteenth Amendments protect civil litigants who seek recourse in the Courts, either as defendants hoping to protect their property or as plaintiffs attempting to redress grievances. *Logan*, 455 U.S., at 429. The Court has long recognized that arbitrary and erroneous deprivations of property through applications of the law by the courts of a state

which deprive a party of a meritorious claim or of its chose in action without the safeguards of due process violate the Due Process Clause. These are fundamental constitutional principles that have been disregarded by the Washington courts in this case. Whether this derives from arbitrariness, as in *Brinkerhoff-Faris*, or from an extreme or erroneous application of the procedural and substantive law, as in *Logan* and *Richards*, the result is the same.

The decisions of the Court of Appeals refusing to recognize a meritorious cause of action on the surety bonds against the American Insurance Company, and the Washington Supreme Court dismissing the appeal, cannot on any rational grounds be reconciled with the authorities and the many cases across the country that support and are directly or implicitly permissive of principal rights to maintain suit against the surety on a surety bond[7]. There are simply no cases or principals of law or provisions in the bonds that prevent this.

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[7] The authorities and cases all recognize principal rights of action against the surety in this relationship. See Restatement (Third) of Suretyship and Guaranty § 22 (1995); 72 C.J.S. Principal and Surety § 226 (1987); Udelman, *Surety Contractors: Are Sureties Becoming General Liability Insurers*, 22 Ariz. St. L. J. 469, 471-485 (1990); *Schmitt v. Insurance Co. of North America*, 230 Cal.App. 3d 245, 281 Cal.Rptr. 261 (1991) (action by purchasers of a motor vehicle and the dealership as principal on a used-car dealer's bond against the surety for tortious breach of the covenant of good faith and fair dealing); *Cushman v. National Surety Corp. of New York*, 4 Ariz. App. 24, 417 P.2d 537, 540-41 (1966) (action by principals against surety, the Court holding in part that surety agreements are to be construed to impose on the surety the obligation of acting in good faith); *Carpenter v. Park*, 19 Cal.App.2d 567, 66 P.2d 224 (1937) (in action against partners of a stock brokerage firm to recover on a note, Court properly permitted partner to file cross-complaint against the surety who had promised to pay the note in the event of a default);

The Due Process Clause has been held to prevent the States from denying individuals the use of established adjudicatory procedures, when the denial would be the "equivalent of denying them an opportunity to be heard upon their claimed rights." *Boddie*, 401 U.S., at 380. In *Logan*, the Court's opinion stated:

> The hallmark of property, the Court has emphasized, is an individual entitlement grounded in state law, which cannot be removed except "for cause." *Memphis, Light, Gas & Water Div. v. Craft*, 436 U.S. 1, 11-12 (1978); *Goss v. Lopez*, 419 U.S. 565, 573-574 (1975); *Board of Regents v. Roth*, 408 U.S. 564, 576-578 (1972). Once that characteristic is found, the types of interests protected as "property" are varied and, as often as not, intangible, relating "to the whole domain of social and economic fact." *National Mutual Insurance Co. v. Tidewater Transfer Co.*, 337 U.S. 582, 646 (1949)[;] . . . . See, *e.g.*, *Barry v. Barchi*, 443 U.S. 55 (1979) (horse trainer's license protected); *Memphis Light, Gas & Water Div. v. Craft*, *supra* (utility services); *Mathews v. Eldridge*, 424 U.S. 319 (1976) (disability benefits); *Goss v. Lopez*, *supra* (high school education); *Connell v. Higginbotham*, 403 U.S. 207 (1971) (government employment); *Bell v. Burson*, 402 U.S. 535 (1971) (driver's license). . . .

Logan v. Zimmerman Brush Co., 455 U.S., at 430-31.

Municipal Court v. Whaley, 55 A. 750 (R.I. 1903) (executor as principal on a surety bond may maintain action against sureties for the default of his coexecutor-coprincipal; *Root v. Moriarty*, 39 Ind. 85 (1872) (in action by principal against surety on a surety bond, Court held that surety should satisfy indebtedness of principal, and that principal, to whom certain claims for labor had been assigned, could maintain suit against surety on the assigned claims).

As in *Logan*, where the right to use Fair Employment Practices Act adjudicatory procedures was found to share the characteristics of the entitlements in these cases, the right to use established state law adjudication procedures in civil actions and proceedings is no less of an entitlement grounded in state law, and equally shares these characteristics. An entity or an individual in a civil action or proceeding in Washington, as in most states, has more than a hypothetical desire in the redress of a civil grievance. The right to recourse is a compact between the State and the individual[8], with the adequacy of a cause of action or of a claim or defense assessed under what this Court described in *Logan* as a substantiality of the evidence standard. 455 U.S., at 431. This, of course, is comparable to a summary judgment standard where the presence of an issue of material fact in civil proceedings precludes the entry of summary judgment. See Washington Civil Rule 56(c); *Honey v. Davis*, 131 Wn.2d 212, 217, 930 P.2d 908 (1997); *Young v. Key Pharmaceuticals*, 112 Wn.2d 216, 225-26, 770 P.2d 182 (1989). The Court's holdings in *Martinez v. California* and later in *Logan*, reflect that the burden of proof as an element in a summary judgment setting is an aspect of the property interest. *Martinez*, 444 U.S., at 282; *Logan*, 455 U.S., at 433.

This case is like *Logan* because it involves state law adjudication procedures that the state system itself

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[8] The Washington Civil Rules form the basis of the entitlement under state law. CR 1 provides, "Scope of Rules. These rules govern the procedure in the superior court in all suits of a civil nature whether cognizable as cases at law or in equity. . . . They shall be construed to secure the just, speedy, and inexpensive determination of every action." CR 3 provides, "Commencement of Action. Except as provided in Rule 4.1, a civil action is commenced by service of a copy of a summons together with a copy of a complaint . . . or by filing a complaint."

destroys, by operation of law, whenever the State fails to recognize potentially meritorious claims, and it is this state procedure that destroys the entitlement without proper procedural safeguards, but the present case is unlike *Logan* because it does not involve procedural limitations on a party's timely assertion of rights after a claim is filed. Rather, it involves the termination of a cause of action by a state system that destroys a substantive element of the state law claim whenever it decides to terminate a potentially meritorious claim, whether this action, as Justice Blackmun wrote, is taken through negligence, maliciousness or otherwise. *Id.*, at 436.

There is no major difference between the state's summary termination of the cause of action and claim here, and the causes of action in the *Richards* and *Brinkerhoff-Faris* cases. The decision of the state courts dismissing the appeal in the present case involves some of these same questions, but in a different context, a principal-surety setting where the dispute is between corporations over property rights of substantial sums on surety bonds. The similarity is that in those cases, an arbitrary or erroneous deprivation of property occurred through an application of the law by the state courts which deprived a party of a claim or chose in action without the safeguards of due process. When the absent procedures would have provided protection against arbitrary and inaccurate adjudication, this Court has not hesitated to find the proceedings violative of due process. *Honda Motor Co. v. Oberg*, 512 U.S. 415, 430 (1994); *In Re Oliver*, 333 U.S. 257, 266-73 (1948); *Tumey v. Ohio*, 273 U.S. 510, 522-24 (1927).

What the Fourteenth Amendment requires, as the Court has held in an important line of cases, "is 'an opportunity . . . granted at a meaningful time and in a meaningful manner,' *Armstrong v. Manzo*, 380 U.S. 545, 552 (1965) (emphasis added), 'for [a] hearing appropriate

to the nature of the case,' *Mullane v. Central Hanover Tr. Co.*, at 313." *Boddie v. Connecticut*, 401 U.S., at 378. This is the opportunity that has been denied by the state courts in this case.

B. EQUAL PROTECTION

The fundamental importance of equal treatment in the courts, and in affording to civil litigants procedural and substantive privileges on an equal basis with other litigants who cannot reasonably be classified differently, are based in the Due Process and Equal Protection Clauses of the Fourteenth Amendment.

This Court long ago held that the right to like treatment in our courts is guaranteed by the Fourteenth Amendment. In *Barbier v. Connolly*, 113 U.S. 27 (1885), this Court wrote, "The Fourteenth Amendment . . . undoubtedly intended . . . that all persons . . . should have like access to the courts of the country for the protection of their persons and property, the prevention and redress of wrongs, and the enforcement of contracts; that no impediment should be interposed to the pursuits of any one except as applied to the same pursuits by others under like circumstances, that no greater burdens should be laid upon one than are laid upon others in the same calling and condition. . . . " 113 U.S., at 31.

The importance of equal treatment in the courts was strengthened by this Court twelve years later in *Gulf, Colorado & Santa Fe Ry. v. Ellis*, 165 U.S. 150 (1897). In this case, the appellant challenged a state statute allowing attorney's fees to successful plaintiffs who sued railroads, without allowing a like privilege to railroads that were also successful. The Court wrote, "The [A]ct singles out a certain class of debtors and punishes them when for like delinquencies it punishes no others. They are not treated as other debtors, or equally with other debtors. *They*

cannot appeal to the courts as other litigants under like conditions and with like protection." 165 U.S., at 153. (emphasis added). In striking down the statute, this Court held, "No duty rests more imperatively upon the courts than the enforcement of those constitutional provisions intended to secure the equality of rights which is the foundation of free government." *Id.*, at 160.

These principles have been found by this Court to be fundamental under the Fourteenth Amendment. In *Chambers v. Baltimore & Ohio R.R.*, 207 U.S. 142 (1907), the Court unequivocally wrote: " . . . there are some fundamental principles which are of controlling effect. The right to sue and defend in the courts is the alternative of force. In an organized society it is the right conservative of all other rights, and lies at the foundation of orderly government. *It is one of the highest and most essential privileges of citizenship, and must be allowed by each State to the citizens of all other States to the precise extent that it is allowed to its own citizens.* Equality of treatment . . . is not left to depend upon comity between the States, but is guaranteed by the Federal Constitution." *Id.*, at 148. (emphasis added). This case primarily concerns the Privileges and Immunities Clause of the Fourteenth Amendment, but it quite clearly applies with equal effect, to the Due Process and Equal Protection Clauses.

Almost sixty years later, in *Baxstrom v. Herold*, 383 U.S. 107 (1966), the Court reviewed New York statutes which guaranteed persons threatened with commitment to mental institutions the right to a jury trial on the issue of sanity and commitment to a civil hospital if found insane, but denied these rights to such persons nearing the end of a criminal sentence.

> The State, having made this substantial review proceeding generally available on this issue, may not, consistent with the Equal Protection

Clause of the Fourteenth Amendment, arbitrarily withhold it from some. 383 U.S., at 111.

About six years later, in *Lindsey v. Normet*, 405 U.S. 56 (1972), the Court confronted in a civil case a double-bond requirement imposed by Oregon Law on tenants seeking to appeal adverse decisions in eviction actions. In finding that the bond requirement violated the Equal Protection Clause, this Court specifically noted that "if a full and fair trial on the merits is provided, the Due Process Clause of the Fourteenth Amendment does not require a state to provide appellate review, *Griffin v. Illinois*, 351 U.S. 12, 18 (1956). . . . When an appeal is afforded, however, it cannot be granted to some litigants and capriciously or arbitrarily denied to others without violating the Equal Protection Clause. *Griffin v. Illinois, supra*. . . ." *Lindsey*, 405 U.S., at 77.

The Court's opinion, by Justice White, found that the double bond-requirement failed equal protection measurement because it raised a substantial barrier to appeal for tenants facing eviction. The opinion noted that the requirement is unrelated to actual rent accrued or to specific damage sustained by the landlord. The Court also found that the requirement bars nonfrivolous appeals by those who are unable to post a bond during an appeal, and that for them, appeal is foreclosed no matter how meritorious the case may be. The nonindigent appellant is also confronted by a substantial barrier to appeal not faced by other civil litigants. As *Lindsey* demonstrates, arbitrary and irrational classifications and actions by a State that burden the right to appeal violate the Equal Protection Clause under even the most deferential standard of review.

Justice Kennedy recently wrote in *Romer v. Evans*, 517 U.S. 620, 633 (1996), "Central both to the idea of the rule of law and to our own Constitution's guarantee of equal protection is the principle that government and each of its parts remain open on impartial terms to all who seek its assistance." Continuing, he wrote, "Equal protection of the laws is not achieved through indiscriminate imposition of inequalities," citing *Sweatt v. Painter*, 339 U.S. 629, 635 (1950).

The decisions by the state courts dismissing the appeal, and holding that a principal cannot sue its surety, American Insurance Company, on surety bonds it issued for its principal, conflict with the reasoning of this Court's equal protection decisions in the cited cases, and cannot in any rational manner be reconciled with the many authorities and cases that all recognize principal rights of action against the surety in this relationship. There are, in short, no authorities or provisions in the bonds that prevent this[9].

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[9] The decision states the question whether a principal on a surety bond may also be an obligee such that it may sue the surety to recover the amount of the bond(s), and holds that the general rules of suretyship law do not allow a principal to sue a surety under the terms of the bonds in this case. The authorities cited do not support this holding. See, *e.g.*, (Third) of Suretyship and Guaranty § 1 (1995); *Honey v. Davis*, 131 Wn.2d 212, 217-18, 930 P.2d 908 (1997); *Schmitt v. Insurance Co. of North America*, 230 Cal. App.3d 245, 258, 281 Cal.Rptr. 261 (1991); *Lumbermens Mutual Casualty Co. v. Agency Rent-A-Car, Inc.*, 128 Cal.App.3d 764, 769, 180 Cal.Rptr. 546 (1982).

The bonds are also broadly worded in coverage (*e.g.*, for the use and benefit of any person having a cause of action under the laws of the states where bonds were issued, and that such person may initiate suit in any court of competent jurisdiction

The state court decisions dismissing the appeal and refusing to recognize a meritorious cause of action present a manifest disparity in treatment by the courts of a state between litigants who cannot reasonably be classified differently, and whose situations are indistinguishable. As in the *Barbier* and *Gulf, Colorado* cases, equal access to the courts has been denied to the petitioner who has not been treated as other litigants in like circumstances, or equally with other litigants, and who has not been able to appeal as other litigants under like conditions and with like protection. Moreover, as in *Baxstrom,* substantial review proceedings are comparably available by summary judgment and appeal, but the review that was made available was transparently denied through state court action that, in effect, shut down a meritorious case. Also, like *Lindsey v. Normet,* appeal is foreclosed for civil litigants like petitioner though arbitrary and irrational state court decisions that make appeal impossible, no matter how meritorious the case may be.

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against the principal and/or the surety on the bonds). Pet. App. D, 7, 9-11. The decision references only the Arizona bond, noting that the bond's beneficiaries are any person with a cause of action against the principal, and that the principal cannot have a cause of action against itself. Pet. App. B, 7. The bond, however, does not under its provisions preclude an action by the principal on behalf of the beneficiaries against the surety. Moreover, surety contracts are construed most strongly against the surety, and in favor of the insured. Couch, Anderson & Rhodes, Cyclopedia of Insurance Law, Volume 11 § 44:6, 190-91 (2nd ed. 1982).

II.

THE DECISION OF THE SUPREME COURT OF WASHINGTON CONFLICTS WITH THE REASONING OF THIS COURT'S DECISIONS IN *LOGAN v. ZIMMERMAN BRUSH CO.*, 455 U.S. 422 (1981), *OPPENHEIMER FUND, INC. v. SANDERS*, 437 U.S. 340 (1977), AND *HICKMAN v. TAYLOR*, 329 U.S. 495 (1947)

The importance of the issues that affect Seabury & Smith and National Union cannot be overstated, and have their significance as property interests in a discovery and summary judgment setting.

Despite all the evidence before the state courts on the motions for summary judgment of Seabury & Smith and National Union in December 1997, and considering the prior denial of motions to compel on the working relationship between themselves and the NASD in the fidelity bond program, which the trial court had stated it was unclear about, their motions were granted, and judgments for approximately $5,700 were granted at that time. After motions for dismissal of the appeal were filed, the judgments were released, and orders of dismissal were entered. See *supra*, at 6-11.

The appeal of discovery and summary judgment issues was continued under the principles in *Purchase v. Meyer*, 108 Wn.2d 220, 737 P.2d 661 (1987). Again, the Court of Appeals refused to review allege errors in the proceedings on the basis that the appeal was dismissed with prejudice. In *Purchase*, the Washington Supreme Court in part held that as a general rule, an appeal will be dismissed if it presents moot issues. An exception exists when matters of substantial public interest are involved. The court must consider: (1) the public nature of the issue; (2) the need for a determination for the future guidance of public officers; and (3) the likelihood of recurrences of the issue. 108 Wn.2d, at 230.

Under *Logan*, it is immediately clear that the right to pursue an appeal after a dismissal has occurred is a cause of action as defined in the *Purchase* case, and a form of property protected by the Due Process Clause of the Fourteenth Amendment. See *Logan*, 455 U.S., at 428-31. *Sorenson v. Bellingham*, 80 Wn.2d 547, 558, 496 P.2d 512 (1972), indicates that the decision whether to review an appeal that has otherwise become moot is discretionary, but the requirement remains that the required criteria *must be considered*. The elements of the cause of action are established adjudicatory procedures to which an entitlement under state law clearly exists. Under *Logan*, this discretionary element would be part of the property interest. 455 U.S., at 433. The state court opinion, however, makes clear that it did not consider the required criteria which form the basis of the claim.[10] This is like *Logan* because it involves an entitlement to state law adjudication procedures and the termination of a cause of action by the state whenever it decides to terminate the

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[10] On the issues affecting the insurers in the appeal, the state court opinion states, "We decline to review these alleged errors as the plaintiffs' appeal with regard to these parties has been voluntarily dismissed with prejudice." There were, however, summary judgment issues of substantial public interest which easily met and transgressed the *Purchase* requirements. For example, an important issue concerns the fidelity coverage that was provided to the broker-dealer. Contrary to their positions on the issuance of a $30,000 bond, the evidence shows that a bond of about $300,000 should have been issued in this case. The importance of obtaining appropriate coverage for broker-dealers in dealings with the public as it affects state residents, and the entire public, is clear. The point is that there is no showing on the record that any of the issues affecting the insurers were considered by the appellate courts, when they must be considered as the *Purchase* decision requires.

entitlement without proper procedural safeguards. *Id.*, at 436. But it is also a form of arbitrariness, and as well involves an immoderate or erroneous application of the substantive law which violated due process in the *Brinkerhoff* and *Richards* cases. See *Brinkerhoff*, 281 U.S., at 681-82; *Richards*, 517 U.S., at 797 and 803-04.

Equally important, this case was not moot. Under state law, a case is moot if a court can no longer provide effective relief. *Orwick v. Seattle*, 103 Wn.2d 249, 253, 692 P.2d 793 (1984). There were important discovery issues on motions to compel in document requests for business agreements between Seabury & Smith, National Union and the NASD, including SDIC, records of corporate meetings and re-insurance agreements involving SDIC, Seabury & Smith, National Union, and the NASD that should have been ordered in this case. See CR 26(b)(1); *Bushman v. New Holland Division*, 83 Wn.2d 429, 434, 518 P.2d 1078 (1974) (state discovery rules are patterned after the federal rules of civil procedure).

The phrase, "relevant to the subject matter . . . in the pending action," is construed broadly to encompass any matter that bears on, or that reasonably could lead to other matter that could bear on, any issue that is or may be in the case. *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 351 (1977); *Hickman v. Taylor*, 329 U.S. 495, 501 (1947). The motions for summary judgment were based on their working relationship and roles with the NASD in the fidelity bond program, but they refused to produce any documentation that could or might shed light on this relationship. Under CR 26(b), the information sought is reasonably calculated to lead to the discovery of admissible evidence, and it is clear that this relationship cannot be discovered or defined until these documents are produced. Under *Logan*, the right to pursue these issues is a cause of action conferred by state law under the *Purchase*

case, and is a form of property to which an entitlement to established state law adjudicatory procedures clearly exists. See *Logan*, 455 U.S., at 430-31. The entitlement was deprived without the proper procedural safeguards. See *Boddie*, 401 U.S., at 378-79.

More importantly, a production order on the motions to compel would or might have established whether American is an AIG company, as National Union is, whether other parties are or may be liable on the surety bonds, and whether American had notice of the action in this case before its addition as a party in the second amended complaint in January 1996. This is why these issues are not moot, and why the state court decisions are in conflict with the decisions in the *Oppenheimer* and *Hickman* cases. This has relevance to relation back of the pleadings to the original complaint in August 1995, which brings into this case earlier surety bond periods in 1989 and 1990. See CR 15(c); *DeSantis v. Merlino & Sons, Inc.*, 71 Wn.2d 222, 427 P.2d 728 (1967); *RTC Transport, Inc. v. Walton*, 72 Wn.App. 386, 864 P.2d 959 (1994). The importance of this discovery information is clear.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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